

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0129

Sales and Use Tax

For Years 1993, 1994, and 1995

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ISSUES

I. Sales Tax – Imposition of Sales Tax on Gross Receipts from Leasing of Pagers and Provision of Paging Services

Authority: Ind. Code § 6-2.5-4-6;
Ind. Admin. Code tit. 45, r. 2.2-1-1;
Indiana Department of Revenue Information Bulletin #51T (revised May 23, 1994);
In the Matter of the Petition of Tri-County Telephone Company, Inc., No. 37234, 1983 Ind. PUC LEXIS 265 (Pub. Serv. Comm'n of Ind. Aug. 24, 1983).

The taxpayer protests the imposition of sales tax on gross receipts from the provision of pagers and paging services to its customers.

II. Use Tax – Imposition of Use Tax on Telephone Service

Authority: Ind. Code § 6-2.5-4-6;
Ind. Admin. Code tit. 45, r. 2.2-4-14.

The taxpayer protests the imposition of use tax on its provision of local telephone service, free of charge, to its employees.

III. Use Tax – Imposition of Use Tax on Purchased Equipment

Authority: Ind. Code § 6-2.5-4-1;
Ind. Code § 6-2.5-5-8.

The taxpayer protests the imposition of use tax on its purchases of pagers and pager parts.

IV. Use Tax – Imposition of Use Tax on Purchased Equipment

Authority: Ind. Code § 6-2.5-5-13;
Ind. Admin. Code tit. 45, r. 2.2-5-20;
Uniform System of Accounts, 47 C.F.R. § 32.2124;
Federal Communications Commission, Responsible Accounting Officers
Letter # 7 (July 1, 1987).

The taxpayer protests the imposition of use tax on its purchases of computer equipment and software and on the purchase of a generator.

V. Use Tax – Imposition of Use Tax on Equipment Given Away

Authority: Ind. Code § 6-2.5-3-1;
Ind. Code § 6-2.5-3-2;
Ind. Code § 6-2.5-4-6.

The taxpayer protests the imposition of use tax on the value of telephones it has given away to its customers.

VI. Tax Administration – Penalty

Authority: Ind. Code § 6-8.1-10-2.1;
Ind. Admin. Code tit. 45, r. 15-11-2.

The taxpayer protests the imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

The taxpayer is an Indiana company that is primarily in the business of providing local telephone service to customers in several west central Indiana counties. A division of the taxpayer provides pager service to locations in west central Indiana. The taxpayer also operates a wholly owned subsidiary that provides cable television service. This subsidiary reports separately for Indiana tax purposes and is not a part of this protest. A sales and use tax audit covering the years 1993, 1994, and 1995, was completed on December 16, 1996. An administrative hearing was held on November 18, 1999, at 2:00 p.m. During the hearing, the taxpayer indicated that he would submit more information regarding the issue of use tax assessed on the purchase of a generator. The taxpayer was given additional time to submit the information but none was submitted. This Letter of Findings is based on the information contained in the taxpayer's Department of Revenue file and issues addressed during the hearing.

I. Sales Tax – Imposition of Sales Tax on Gross Receipts from Leasing of Pagers and Provision of Paging Services

DISCUSSION

The taxpayer protests the imposition of sales tax on its leasing of pagers and provision of paging services to its customers for the entire audit period. The taxpayer argues that in its three prior sales and use tax audits, it had not been assessed sales tax on pager services. The taxpayer maintains that the gross receipts it receives from leasing pagers to its customers are exempt from sales tax because the taxpayer is a public utility. The taxpayer also argues that it had not been given notice that it would be assessed sales tax during the audit period in question. The taxpayer charges a single fee that includes the provision of the pager service and the lease of the pager.

The taxpayer has submitted a decision from the Public Service Commission of Indiana (now the Indiana Utility Regulatory Commission) which names the taxpayer a public utility as defined in the Public Service Commission Act. In the Matter of the Petition of Tri-County Telephone Company, Inc., No. 37234, 1983 Ind. PUC LEXIS 265 (Pub. Serv. Comm'n of Ind. Aug. 24, 1983). A representative of the Indiana Utility Regulatory Commission has confirmed by telephone that the taxpayer is a public utility. Prior to July 1, 1993, Ind. Code § 6-2.5-4-6 provided that local exchange telephone service or intrastate message toll telephone service furnished by a public utility was subject to sales tax. Prior to July 1, 1993, pager service furnished by a public utility was not subject to sales tax. Effective July 1, 1993, Ind. Code § 6-2.5-4-6 was amended so that sales tax applies to the provision of telecommunication services, including pager service, whether or not the provider is a public utility. (See Department of Revenue Sales Tax Information Bulletin #51T, revised May 23, 1994.) The taxpayer's prior audits were for periods before the effective date of the amendment to Ind. Code § 6-2.5-4-6, therefore, the taxpayer was not assessed sales tax for providing pager services during that time.

The pagers are leased with the pager service and billed as a single charge.

(a) Unitary Transaction. For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

(b) Unitary Transaction – Public Utility. For purposes of the state gross retail tax and use tax, all public utility services and commodities subject to said taxes invoiced in a single billing or statement, including a minimum charge, submitted to a consumer for payment shall constitute a unitary transaction.

Ind. Admin. Code tit. 45, r. 2.2-1-1.

The taxpayer's leasing of pagers and pager service, and billed to its customers as a single item, constitutes a unitary transaction. As such, the entire amount is subject to sales tax. However, the Department finds that the taxpayer is not liable for sales tax on its leasing of pagers and pager

services for the audit period prior to July 1, 1993, the effective date of the amendment to Ind. Code § 6-2.5-4-6.

The Department of Revenue is not required to notify individual taxpayers when there is a change in the law. All legislation and proposed legislation is a matter of public record. It is the taxpayer's responsibility to keep informed about legislation that may affect its business operations.

FINDING

The taxpayer's protest is partially sustained and partially denied. The taxpayer is not liable for sales tax for its leasing of pagers and pager services prior to the effective date of the amendment to Ind. Code § 6-2.5-4-6 but is liable for sales tax after that date.

II. Use Tax – Imposition of Use Tax on Telephone Service

DISCUSSION

The taxpayer was assessed use tax on the local telephone service it provided free of charge to its employees as an employee benefit. The taxpayer argues that since it received no gross receipts in return for this service, use tax should not have been assessed. In support of its argument, the taxpayer cites Ind. Code § 6-2.5-4-6(b) which states that a person is a retail merchant making a retail transaction when that person "(1) furnishes or sells an intrastate telecommunication service; and (2) receives gross retail income from billings or statements rendered to customers." Additionally, the Administrative Code provides:

In general, the furnishing of telephone services by public utilities to consumers is subject to the state gross retail tax. The gross receipts of public utilities from the furnishing of local exchange telephone service or intrastate message toll service is subject to the state gross retail tax. The tax applies to the total receipts of such public utilities for furnishing such services.

Ind. Admin. Code tit. 45, r. 2.2-4-14(a).

The cited statute and administrative regulation indicate that sales or use tax would apply only to gross receipts collected in return for provision of telecommunications services. In this case the taxpayer does provide telecommunications services, in the form of local telephone service, to its employees. However, the taxpayer collects no receipts in return for providing this service. The Department finds that use tax is not owed on the taxpayer's provision of local telephone service to its employees free of charge. The exemption applies to the provision of local telephone service only. Any provision of tangible personal property by the taxpayer to its employees would be subject to tax.

FINDING

The taxpayer's protest is sustained.

III. Use Tax – Imposition of Use Tax on Purchased Equipment**DISCUSSION**

The taxpayer was assessed use tax on its purchase of pagers and pager parts. The pagers were subsequently leased to the taxpayer's customers. The taxpayer argues that its purchases of pagers and pager parts are exempt from sales and use tax as a wholesale sale under Ind. Code § 6-2.5-4-1(d). "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property." Ind. Code § 6-2.5-5-8. The taxpayer provides pagers and pager service to its customers in a unitary transaction. A portion of the amount charged to the taxpayer's customers represents the leasing of the pagers. The purchases of the pagers and pager parts by the taxpayer constitute the acquisition of tangible personal property for lease and are, therefore, exempt from sales and use tax.

FINDING

The taxpayer's protest is sustained.

IV. Use Tax – Imposition of Use Tax on Purchased Equipment**DISCUSSION**

The taxpayer was assessed use tax on purchases of computer equipment and software and on the purchase of a generator. The taxpayer claims that the equipment purchased was all central office equipment and exempt under Ind. Code § 6-2.5-5-13. That statute does exempt certain equipment purchased by a public utility that furnishes or sells intrastate telecommunications service if the equipment is "classified as central office equipment, station equipment or apparatus, station connection, wiring, or large private branch exchanges according to the uniform system of accounts which was adopted and prescribed for the utility by the Indiana utility regulatory commission." Ind. Code § 6-2.5-5-13(1)(A). In defining non-exempt, general purpose computers, the Indiana Utility Regulatory Commission has adopted the Uniform System of Accounts as contained in 47 C.F.R. § 32:

General Purpose Computers

- (a) This account shall include the original cost of computers and peripheral devices which are designed to perform general administrative information processing activities.
- (b) Administrative information processing includes but is not limited to activities such as the preparation of financial, statistical, or other business analytical reports; preparation of payroll, customer bills, and cash management reports, and other records and reports not specifically designed for testing, diagnosis, maintenance or control of the telecommunications network facilities.

(c) This account shall include the original cost of initial operating system software for computers classifiable to this account whether acquired separately or in conjunction with associated hardware.

(d) This account does not include the cost of computers, their associated peripheral devices, and their initial operating system software associated with switching, network signaling, network operations or other specific telecommunications plant. Such computers, peripherals, and software shall be classified to the appropriate switching, network signaling, network expense, or other plant account.

47 C.F.R. § 32.2124

In a Responsible Accounting Officers Letter, the Federal Communications Commission has provided examples of how certain computers should be classified:

[T]he processor for a digital electronic switch will be classified with the switch to Account 2212, Digital Electronic Switching [exempt under Ind. Code § 6-2.5-5-13 as central office equipment]; a personal computer that interfaces with circuit equipment for the purpose of testing such equipment will be classified to Account 2232, Circuit Equipment [exempt as central office equipment]; and, a computer that is used for the monitoring and regulation of a building temperature will be classified to Account 2121, Buildings [non-exempt because it is a general support asset, not central office equipment]. A computer used for general and administrative purposes (e.g., formulation of company policy and strategy, administration of payroll and disbursements, and other such corporate Operations) shall be classified as general purpose computer, whether used exclusively for one such operation or for several, and recorded in Account 2124 [non-exempt because it is a general support asset, not central office equipment].

Computer expenses, other than related depreciation, shall be classified to the appropriate plant specific expense account, that is, the expense account that mirrors the plant account the computer giving rise to the expense is recorded in.

Federal Communications Commission, Responsible Accounting Officers Letter # 7 (July 1, 1987)(answer to question # 7).

Thus, the taxpayer's purchases of computer equipment and software are exempt from use tax to the extent that the equipment and software represent computer peripheral devices, initial operating software, and computer expenses associated with switching, network signaling, network operations or other specific telecommunications plant. The taxpayer's purchases are subject to use tax to the extent that the equipment and software is associated with administrative information processing. In its protest letter, the taxpayer did not specifically indicate which purchases of computer equipment or software it believed to be exempt from use tax. Upon review of the Department of Revenue Schedule AD-7 for this taxpayer, it was found that several items, which were assessed tax by the auditor, could have actually been exempt purchases by the taxpayer. Per a telephone conversation held on February 23, 2000 with the accountant for the

taxpayer, it was determined that all of the purchases of computer equipment and software were for administration and business office purposes and, therefore, not exempt. Use tax was properly assessed on these purchases.

The taxpayer purchased a 60 kva generator during the audit period that was installed at one of its offices. The auditor exempted the taxpayer's purchases of generator parts and fuel but exempted only ten percent (10%) of the cost of the generator. The auditor stated that the generator was used primarily to support the taxpayer's accounting offices, a non-exempt function. The auditor estimated that the taxpayer required a 5 kva generator to support the telephone communications operation at the office where the generator was installed. A 5 kva generator would be approximately ten percent (10%) of the size that the taxpayer actually purchased, resulting in the ten percent (10%) exemption allowed in the audit report.

Central office equipment purchased by a public utility that furnishes or sells intrastate telecommunications service is exempt from sales and use tax. Ind. Code § 6-2.5-5-13. Generators are specifically listed as exempt central office equipment under Ind. Admin. Code tit. 45, r. 2.2-5-20(a). The equipment exempted under Ind. Admin. Code tit. 45, r. 2.2-5-20 is that which is related to the actual provision of intrastate telecommunications service. The auditor determined that ninety percent (90%) of the capacity of the generator was used for purposes unrelated to the provision of telecommunications service. The taxpayer was given an opportunity to submit evidence showing that the entire capacity of the generator, or a portion of the capacity greater than ten percent (10%), was used to support the provision of telephone services. The taxpayer failed to submit any such evidence. The taxpayer is entitled to a tax exemption on the purchase of the generator to the extent that it can be used for an exempt purpose, that is, the provision of telecommunications services. The audit report is correct in granting an exemption for ten percent (10%) of the purchase price of the generator and assessing use tax on the remaining ninety percent (90%) of the purchase price.

FINDING

The taxpayer's protest is denied.

V. Use Tax – Imposition of Use Tax on Equipment Given Away

DISCUSSION

The taxpayer was assessed use tax on its purchases of telephones. The telephones were given by the taxpayer, free of charge, to its customers as an incentive to sign up for enhanced services including call waiting, voice mail, and caller ID. The taxpayer argues that the provision of the telephones to its customers is not a retail transaction and is thus exempt from use tax under Ind. Code § 6-2.5-4-6(c). That section of the statute states in part:

- [A] person is not a retail merchant making a retail transaction when:
 - (1) the person provides, installs, constructs, services, or removes tangible personal property which is used in connection with the furnishing of the telecommunications services described in subsection (a);
 - (2) the person furnishes or sells the telecommunications services described

in subsection (a) to another person described in this section or in section 5 of this chapter

Ind. Code § 6-2.5-4-6(c).

The taxpayer was assessed use tax on its purchases of the telephones it subsequently gave away, not on the provision of the telephones to its customers. The use tax “is imposed on the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.” Ind. Code § 6-2.5-3-2(a). The term, use, “means the exercise of any right or power of ownership over tangible personal property.” Ind. Code § 6-2.5-3-1(a). The taxpayer purchased the telephones from its supplier in a retail transaction and owned the telephones before giving them away to its customers. The taxpayer is, therefore, liable for the payment of use tax on the telephone purchases it made.

FINDING

The taxpayer’s protest is denied.

VI. Tax Administration – Penalty

DISCUSSION

The taxpayer protests the imposition of the ten percent (10%) penalty for negligence. The taxpayer maintains in its protest letter that its failure to remit sales and use tax was not due to negligence and that it exercised ordinary business care and prudence in reporting and paying sales and use tax. Additionally, the taxpayer states that much of the penalty assessed stemmed from an accounting mistake where a wholly-owned subsidiary of the taxpayer reported a portion of the taxpayer’s gross receipts. “If a person incurs, upon examination by the department, a deficiency that is due to negligence, the person is subject to a penalty.” Ind. Code § 6-8.1-10-2.1(a)(3). The penalty is ten percent (10%) of “the amount of the deficiency as finally determined by the department.” Ind. Code § 6-8.1-10-2.1(b)(4). Negligence is defined in the Administrative Code as “the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer’s carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations.” Ind. Admin. Code tit. 45, r. 15-11-2(b).

Provision is made for the waiver of the ten percent (10%) penalty:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in

carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Ind. Admin. Code tit. 45, r. 15-11-2(c).

Although the taxpayer has prevailed on some issues, it has failed to affirmatively show reasonable cause for not remitting the tax due. The penalty in this case is proper.

FINDING

The taxpayer's protest is denied.